UNITED STATES SENATE
REPUBLICAN
POLICY COMMITTEE

Larry E. Craig, Chairman
Jade West, Staff Director

February 14, 2001

Tax Relief for All Taxpayers

More Surplus than Debt: Another Argument for Tax Relief Now

With all the buzz around Federal Reserve Chairman Alan Greenspan's endorsement last month of broad-based tax cuts before the Senate Budget Committee, it is easy to lose the central message of his testimony. Chairman Greenspan's key point was that projected federal surpluses are slated to grow so large that – absent action by Congress – they literally threaten our economic well- being.

President Bush has proposed a balanced plan for paying down the federal debt while offering broad-based tax relief that would stimulate economic growth, reduce the record tax burden on families, and address the destructive marriage penalty and death tax. This plan is wholly consistent with Chairman Greenspan's goal of gradually reducing budget surpluses over the next decade to avoid an economic shock.

President Bush's proposal for broad-based tax relief is not only good for the economy and families, it is also a necessary component of responsible fiscal policy.

Unprecedented Surpluses

Fiscal Year 2001 is the fourth year in a row the federal government will enjoy a budget surplus. By all accounts, those four years are just the beginning. According to the Congressional Budget Office (CBO)'s latest estimates released in January 2001, over the next 10 years the federal government will take in $5.6 trillion more than it is slated to spend.

The Budget Outlook Under Current Policies

(By fiscal year, in billions of dollars)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	**02-11**
On-Budget Surplus	86	125	142	171	196	212	267	316	359	417	484	558	**3,122**
Off-Budget Surplus*	150	156	171	188	201	221	238	257	276	294	312	331	**2,488**
Total Surplus	236	281	313	359	397	433	505	573	635	710	796	889	**5,610**

Source: Congressional Budget Office (numbers may not add due to rounding). *Social Security system.

The annual surpluses rise from just under $300 billion this year to almost $1 trillion in 2011. As Chairman Greenspan told the Budget Committee, "The most recent projections, granted their tentativeness, nonetheless make clear that the highly desirable goal of paying off the federal debt is in reach before the end of the decade."

Paying Off the Debt – Not as Simple as it Sounds

The question of how to pay down the debt is a relatively new one. Just three years ago, CBO addressed the issue of making the transition from deficits to surpluses:

> "As a matter of course, the Treasury issues and redeems securities every week. When the government ran large deficits, the Treasury would normally sell enough securities at each auction to roll over any maturing debt plus a little extra to raise new cash. By those means, the debt has essentially grown by increments — auction by auction and week by week. The Treasury can use the same means to reduce the size of the outstanding debt. Depending on cash needs at any given time, the Treasury could issue a little bit less than necessary to refinance maturing debt fully." [CBO -- Budget Outlook 1998]

According to the CBO, debt held by the public is $3.4 trillion. Current surplus projections would exceed that amount sometime in the year 2008. Paying off the federal debt, however, is not the same as paying off your credit card. Treasury cannot simply cut a check to its creditors. Federal debt comes in many shapes and sizes. Much of it will come due over the next few years. Some of it won't come due for more than two decades. The CBO calls the debt which comes due outside the 10-year window "unredeemable."

The existence of this unredeemable debt means the Treasury would begin holding large cash balances prior to 2008. The CBO estimates that these "surplus" surplus funds will materialize as early as 2006, with economically significant balances emerging the following year. These surplus balances are itemized in the line labeled "Uncommitted Funds" in the chart below, and are projected to amount to more than $3 trillion from 2006 to 2011.

The Budget Outlook Under Current Policies

(By fiscal year, in billions of dollars)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	02-11
Total Surplus	236	281	313	359	397	433	505	573	635	710	796	889	5,610
Debt Held by the Public	3,410	3,148	2,848	2,509	2,131	1,714	1,251	1,128	1,039	939	878	818	n.a.
Uncommitted Funds	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	28	466	1,003	1,608	2,338	3,164	n.a.

Source: Congressional Budget Office

The problem, as outlined by Chairman Greenspan and others, is that once all the available debt is repurchased by the Treasury Department, the government has no place to put the additional revenues coming into the Treasury. What happens if, four or five years from now, the federal government is still running surpluses, yet all the debt available to purchase is gone?

Debt-Free: What Should Uncle Sam Do with Cash on Hand?

What should Treasury do with the surplus cash? It could:

- Stuff the Surplus in a Big Mattress;
- Deposit the Surplus in a Bank for a "Rainy Day" Fund;
- Invest the Surplus in Private Assets;
- Spend the Surplus; or
- Allow Taxpayers to Keep Their Own Money!

While the idea of hoarding surpluses may seem ridiculous, it *has* been suggested in the past that the Treasury should just allow large balances to build up. This option, of course, is simply out of the question. The CBO estimates that we will have a $433 billion surplus in 2005. That equals almost 4 percent of anticipated GDP that year. Sucking that much cash out of the economy would be deflationary and hinder economic growth. Congress *will have* to do "something" with the money. We need to make decisions today – in the 107th Congress – to avoid harming the economy in 2005.

On the other hand, stashing the cash in some bank account for a "rainy day" fund simply is not feasible. The nation's largest bank is Bank of America with assets of some $640 billion. If the CBO surplus projections prove true, within two years Uncle Sam would be the largest depositor in the United States. Imagine the impact on the international financial industry.

Direct government investment in private industry was proposed by the Clinton/Gore Administration last Congress. The idea never gained any traction. Concerns with government investing funds in private industry are two-fold. First, the scope of investment would be unprecedented. In year one, the Treasury could purchase Microsoft, Sun Microsystems, and Compaq at their current market values. Year two would add Intel, Hewlett-Packard, IBM, Texas Instruments, Gateway, Dell, Cisco Systems, AT&T, and Lucent. Nobody but the most diehard Socialist would argue that Uncle Sam's ownership of most of America's Internet, telecommunication, and computer industries is prudent or wise policy.

The second concern regarding direct federal investment is more political. Even if Treasury were to spread its investments throughout the entire economy, there is little doubt that certain sectors – today energy and tobacco come to mind – would be less popular than others. Pressure from Congress and the Executive to divest the government from these politically unpopular investments is inevitable. The market-manipulation potential is enormous.

Chairman Greenspan argued against direct government before the Budget Committee last month:

> "I believe, as I have noted in the past, that the federal government should eschew private asset accumulation because it would be exceptionally difficult to insulate the government's investment decisions from political pressures. Thus, over time, having the federal government hold significant amounts of private assets would risk sub-optimal performance by our capital markets, diminished economic efficiency, and lower overall standards of living than would be achieved otherwise."

The CBO made the same point — more succinctly albeit — in its "Long-Term Budget Outlook" from October:

> "Accumulating assets of such magnitude would be unprecedented in U.S. history and would raise questions about direct involvement by the government in private firms."

Finally, Congress could either spend the surplus, return it to the taxpayer, or some combination of the two. Faced with these options, Chairman Greenspan made clear his preference is tax cuts over new spending: "In general, as I have testified previously, if long-term fiscal stability is the criterion, it is far better, in my judgment, that the surpluses be lowered by tax reductions than by spending increases."

Consensus Debt Relief

How probable is it that the Treasury will run out of redeemable debt in the next 10 years? Very. Both Congress and the Bush Administration have agreed that spending and revenue proposals should be limited to the on-budget surplus. The Social Security surplus is not going to be touched. Many have argued that the Medicare surplus should be set aside as well.

If Congress and the President were to agree to *just this minimum level* of debt reduction — Social Security and the Medicare Part A surpluses only — we still would soon face the same concerns that confront us if we saved the on-budget surplus: more cash on hand than redeemable debt. As the chart below from CBO testifies, we will have accumulated a surplus beyond the redeemable debt of $434 billion in 10 years.

Projections of Net Indebtedness at Year-End if Both Off-Budget Surpluses and Medicare Hospital Insurance Trust Fund Surpluses Go to Debt Reduction After 2001

(By fiscal year, in billions of dollars)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Balance of Debt Held by the Public	3,410	3,148	2,955	2,747	2,524	2,279	2,011	1,724	1,418	1,089	878	818
Balance of Uncommitted Funds	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	133	434
Net Indebtedness	3,410	3,148	2,955	2,747	2,524	2,279	2,011	1,724	1,418	1,089	745	384

SOURCE: Congressional Budget Office.

Planning for Success – the Sooner the Better

The most recent CBO report and Alan Greenspan's testimony carry the same essential message: Absent an economic shock or record congressional spending spree, Congress will have to come to grips with excess surpluses within the decade, and possibly much sooner than that. Responsible fiscal policy mandates, in the words of Chairman Greenspan, that "budget policy should strive to limit potential disruptions by making the on-budget surplus economically inconsequential when the debt is effectively paid off."

These "surplus" surpluses, in turn, make an already strong case for tax cuts all the stronger. We either give taxpaying workers more control over their money through tax relief, or we grow the size and scope of government to record proportions – proportions that literally threaten the concept of a limited federal government.

As Chairman Greenspan noted in his comments yesterday before the Senate Banking Committee, the implications of this forthcoming fiscal situation are very profound for the rest of this decade, as well as the decade to come, and "the sooner it is addressed the better."

Written by Brian Reardon, 224-2946